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C O N F I D E N T I A L SECTION 01 OF 03 KUWAIT 004311

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SUBJECT: IRAQ COMPACT: ARAB FUND PROMISES CONTINUED SUPPORT, MAY END IRAQ'S SUSPENSION

REF: KUWAIT 4119

Classified By: Ambassador Richard LeBaron for Reasons 1.4 (b) and (d)

¶1. (C) Summary: During a November 1 meeting with Treasury Deputy Secretary Kimmitt, Arab Fund Director General Abdul Latif al-Hamad reiterated the Fund's "unwavering" support for the Iraq Compact, despite the absence of the Fund from the October 31 Iraq Compact (ICI) Prep Group meeting due to commitments elsewhere. Kimmitt provided Al-Hamad with a read-out of the ICI meeting, outlining progress made on the Compact document and agreement on a follow-up meeting at the UN in New York on November 10. Kimmitt welcomed interest among a widening circle of countries -- Russia, China, Turkey, Denmark -- in the Compact, along with a deepening involvement of Iraqi officials in the economic process in Iraq and active engagement in the ICI process from regional financial institutions. Al-Hamad commented that technically Iraq had been suspended from the Arab Fund because of outstanding debts, but he had met that morning with an Iraqi delegation led by Planning Minister Baban, and a solution was in process to re-enlist Iraq as the GOI gradually paid down its arrears. On Lebanon, Al-Hamad said the Arab Fund sought to move in quickly after the end of hostilities between Israel and Hizballah over the summer to help demonstrate that not only Hizballah and Iran could provide assistance to the Lebanese. He believed, in fact, that Hizballah had "over-promised and under-delivered." Kimmitt told Al-Hamad that the outlook for the U.S. economy for the near and mid-term was positive. End Summary.

Iraq Compact

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¶2. (C) Treasury Deputy Secretary Robert Kimmitt met with Director General of the Arab Fund for Social and Economic Development, Abdul Latif Al-Hamad, on November 1, following the conclusion of the Iraq Compact Preparatory Group meeting in Kuwait the previous day. Kimmitt was accompanied by Treasury DAS Ahmed Saeed, Embassy Baghdad Treasury Attach Jeremy Pam, NEA/I Deputy Director Laird Treiber, and Econcouns (notetaker). Kimmitt thanked Al-Hamad for the Arab Fund's participation in the ICI meeting in Abu Dhabi in September and for Al-Hamad's active participation in ICI events in Singapore. Al-Hamad repeated an earlier complaint that the UN had not been effective at keeping the Fund informed of ICI activities, noting he had learned of the meeting in Kuwait from the U.S. Embassy (reftel). Kimmitt said the U.S. would press the UN to do a better job of

keeping donors informed.

¶3. (C) Since the Arab Fund had not been able to attend the October 31 ICI meeting, Kimmitt briefed Al-Hamad on progress and the latest state of play. Kimmitt said the PG members were close to full consensus on a Compact document and had made good progress in solidifying Iraqi commitments.

Although little time had elapsed since the ICI process had gotten underway, the document under discussion was excellent.

It was necessary to move fast because the situation on the ground in Iraq was evolving quickly. The U.S. believed that progress on the economic side would have a positive political effect and work to stem the violence in Iraq. PG members had made progress in August, despite the European hiatus, and more since the Abu Dhabi meeting in September. Kimmitt noted the Kuwaiti FM had given an excellent opening speech, and twenty countries and organizations had participated.

¶4. (C) Kimmitt said the next step was a November 10 meeting at the UN in New York, to which all countries would be welcome, to prepare for the ministerial at the end of November. The ministerial would be held somewhere in the region. Interest in the ICI was broadening, to include Russia, China, Turkey, and Denmark. Kimmitt hoped that Al-Hamad would demonstrate the Fund's support for the ICI by personally attending subsequent meetings. The Arab Fund had important expertise to bring to the table.

¶5. (C) Kimmitt added that debt forgiveness was a key way for donors to help Iraq. It was important to "clear the balance sheet" and encourage foreign investment in Iraq despite the security situation. A number of countries, including the United States, had forgiven 100% of Iraqi debt.

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¶6. (C) Kimmitt said the ICI process had produced two tangible results. First, a wide array of serious Iraqi officials had become deeply involved in the economic process in Iraq. Iraqi Deputy PM Barham Salih had brought with him to Kuwait, in addition to government colleagues, the Deputy Speaker of Parliament and a number of business people, a very savvy move. Second, generous offers by the UAE and Kuwait to host ICI meetings, along with active participation by regional financial institutions, sent an important signal to the region and the international community, including to Europe and Asia.

¶7. (C) Al-Hamad responded that the Arab Fund was committed to playing a role in the Compact -- "absolutely." The Fund was unwavering, albeit thinly staffed. As a sign of its commitment, the Arab Fund was moving forward on re-enstating Iraq as a member of the Fund. Technically and legally, he said, Iraq's membership had been suspended. Al-Hamad had met earlier in the day with an Iraqi delegation led by Minister of Planning Baban. They discussed the issue of Iraqi arrears, and a solution was in the making. Iraq owes the Fund 31 million Kuwaiti dinar (roughly USD 108 million). The Iraqis proposed resuming payments at the rate of one million dinar per month with an initial tranche of five million dinar. Once payments start, Al-Hamad said, the Fund could begin work in Iraq, such as pursuing a USD one hundred million potable water system in the south. The decision would rest with the Fund's board, Al-Hamad stressed, but he saw no reason why the board would object. A positive decision would not entail breaking new ground. The Iraqis would also have to review the repayment plan once they returned to Baghdad.

¶8. (C) Kimmitt said this was very good news, and he welcomed the trilateral aspect of the water project, with the Fund, GOI, and Japan working together. He stressed the importance of the Fund remaining engaged in Iraq; Al-Hamad agreed that governments could be fickle, so it was more likely financial institutions like the Arab, Kuwait, and Saudi funds would be the long-term development players in Iraq. Kimmitt added

that Minister Baban was an excellent interlocutor who worked closely with Barham Salih and Iraq's Finance Minister. Kimmitt hoped the Iraqi government would move quickly to endorse the repayment plan.

¶9. (C) Kimmitt and Al-Hamad agreed that Iraq's economic development could not wait for an improved security environment. Al-Hamad said a degree of instability was intrinsic to the region, and one had to accept that or nothing would ever get done. Kimmitt noted that, on the positive side, the Iraqi currency was stable, and oil revenue was increasing. On the other hand, dollarization was higher than hoped, inflation was creeping beyond the transportation sector, and there was continuing corruption, especially before funds reach government accounts. Iraq needed to liberalize and open its banking system. Nevertheless, Iraq's economic leaders were solid professionals, and they were doing well under the circumstances. The real challenge was producing tangible results and getting the message to the people. The insurgents understood that and sought to undermine development projects.

¶10. (C) Al-Hamad asked to be kept posted on the Compact and hoped he would be able to attend the November 10 and subsequent meetings.

Lebanon

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¶11. (C) Kimmitt raised Arab Fund assistance to Lebanon. Al-Hamad said the Lebanese people need to see results. He described the Lebanese political system as a "Phoenician bazaar" and said one could not expect development there along European lines. The Arab Fund sought to be active in Lebanon immediately after the hostilities between Israel and Lebanon ended this summer, and the Fund was working on USD 400 million in projects to rebuild infrastructure. It was essential to demonstrate to the Lebanese that not only Hizballah and its Iranian backers could provide aid. Al-Hamad said he was hearing from contacts that Hizballah had "over-promised and under-delivered."

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U.S. Economy

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¶12. (C) Kimmitt said he was upbeat about the U.S. economy despite a slightly weaker than expected third quarter. Prospects were good for continuing non-inflationary growth and low unemployment. A correction in the housing market had been anticipated by the market and was underway. Deficit reduction was a key priority, as is China, an issue of sufficient import that it has been elevated to the strategic dialogue level. Al-Hamad said keeping the dollar healthy and sound was essential to global economic stability.

¶13. (U) Deputy Secretary Kimmitt has cleared this message.

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